

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

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| Illinois-American Water Company |) | |
| |) | |
| |) | Docket No. 16-0093 |
| Proposed Rate Increase for Water |) | |
| and Sewer Service |) | |

**REPLY IN SUPPORT OF STAFF'S
MOTION TO STRIKE PORTIONS OF THE
INITIAL BRIEF OF ILLINOIS-AMERICAN WATER COMPANY**

NOW COMES the Staff of the Illinois Commerce Commission (“Staff”), by and through their undersigned counsel, pursuant to Section 200.190 of the Illinois Commerce Commission’s Rules of Practice (83 Ill. Adm. Code 200.190), and the direction of the Administrative Law Judges (“ALJs”) and in reply to the Response of Illinois-American Water Company (“IAWC” or the “Company”) to Staff’s motion to strike portions of the IAWC’s Initial Brief (“Motion”) and in further support of Staff’s Motion, states as follows:

In its initial brief (“IB”), the Company offered, for the first time in the proceeding, an extensive (although incomplete) discussion of the DCF methodology used by FERC, relying heavily on select portions of the FERC order in which that methodology is established. *Martha Coakley v. Bangor Hydro-Electric Co.*, Opinion No. 531, 147 FERC ¶ 61,234 (2014) (“Opinion No. 531”). Staff’s Motion seeks to strikes this discussion.

In Response to Staff’s Motion, the Company argues that the Opinion No. 531 is not cited as evidence and that it does not introduce new facts to this case. Rather, the

Company contends, the “Order and accompanying discussion are simply *legal argument*.” (IAWC’s Response to Staff’s Motion (“Response”), 1 (emphasis added).) The Company suggests that Opinion No. 531 is simply a “legislative fact” of which the Commission can take notice. It seems the very thing the Company argues in support of its contention that discussion of the opinion is allowable as argument – that it’s a legislative fact – is contrary to the Company’s suggestion that the discussion is only argument. To call this circular reasoning would be an understatement and, despite the Company’s detailed discussion, calling facts adjudicative versus legislative is a distinction without a difference.

Staff certainly does not suggest the Commission and the ALJs cannot rely on relevant case law and previous Commission orders in considering evidence and arguments in a given proceeding; there is no question that the Commission can rely on competent authority deemed by the ALJs and Commission to be relevant to Commission deliberations. What Staff questions in this instance is 1) the applicability of a FERC decision regarding electric transmission companies to the Commission’s deliberations regarding an Illinois water utility without any demonstration that the opinion is relevant, and 2) the legitimacy of citing large sections of Opinion No. 531 without acknowledging or conceding that the opinion is contrary to the testimony adduced by the Company’s witness. Staff’s Motion is premised less on the fact that the FERC order is not part of the record and more on the fact that it is used incorrectly, cited incompletely, and is contrary to the Company’s record evidence. “Reference to the FERC order is inappropriate because it is not part of the record. More importantly, the arguments that IAWC makes in reliance on that order are not only not supported by the record, they are contrary to IAWC’s own evidence and accordingly should be stricken.” (Motion, 6-7.)

The Company's response, which relies entirely on an argument that Opinion No. 531 is a "legislative fact," is not well founded. "Legislative facts" are general facts which help the tribunal decide questions of law and policy and discretion. See Peabody Coal Co. v. Illinois Pollution Control Board, 36 Ill. App 5, 34 N.E.2d 279 (5th Dist. 1978). It is entirely unclear what the Company considers to be a "legislative fact" in this proceeding. Is it the fact that FERC issued an opinion? Is it the fact that Opinion No. 531 exists? Is it the fact or facts themselves found in the FERC order? And if it is the latter, which facts?

It is entirely disingenuous to quote entire sections from the FERC order and then suggest those sections are just argument, especially where – as here – the Company has absolutely failed to (a) raise Opinion No. 531 prior to its IB; or (b) offer any basis, legal or evidentiary, why Opinion No. 531 should be considered in this case. The statements set forth in the Company's IB belie the Company's contention that it is simply making a legal argument. In fact, the Company introduces a discussion of the FERC methodology by stating, "As an institution of considerable technical skill and prestige,¹ FERC's conclusions deserve attention." (IAWC IB, 12; footnote added.) In other words, to the extent the Company is making a legal argument when it discusses the FERC order, that legal argument is that the Commission should follow FERC's lead and not take DCF results at face value.

Because IAWC has utterly failed to demonstrate relevance, Staff contends the FERC sections in the Company's IB should be stricken. Should the ALJs be disinclined to grant Staff's Motion however, either because the ALJs determine that Opinion No. 531

¹ What, if any, technical skill or prestige FERC, charged with regulating interstate electric transmission and power markets, possesses with respect to determining the return on equity for intrastate water companies is something that IAWC has yet to even attempt to explain.

is relevant or they are persuaded by the Company's arguments, Staff requests in the alternative that the ALJs take administrative notice of Opinion No. 531 in its entirety pursuant to 83 Ill. Adm. Code 200.640(a).² (A copy of Opinion No. 531 is attached as Appendix A and incorporated by reference.) If the Company is allowed to reference Opinion No. 531, Staff and other parties should have that same right so that the Opinion can be considered in its entirety. In its IB, the Company appears to contend that the FERC ruling adds validity to its ROE recommendation because applying the FERC methodology would lead to a result similar to the Company's, but this ignores the fact that, in its testimony and evidence, the Company itself unequivocally urged the Commission to reject the methodology upon which FERC relies. The Company simply cherry picks the portions of the opinion it considers supportive of its arguments and ignores everything else, but Opinion No. 531, in its entirety, underscores just how unreasonable the Company's ROE recommendation is and Staff and the other parties should be able to advance arguments in this regard.³

The relevant finding in Opinion No. 531 is the adoption of a two-step methodology to establish the growth rate used in a DCF analysis for public utilities, where prior rulings used a one-step methodology. The two-step methodology sets the growth rate by giving 2/3 weight to the short-term growth rate and 1/3 weight to the long-term growth rate.⁴ Conversely, the Company considers only a short-term, five-year growth rate. (IAWC Ex.

² The Commission may take administrative notice under Rule 200.640 "consistent with Section 200.610", but pursuant to Section 200.610(a), "irrelevant...evidence shall be excluded." 83 Ill. Adm. Code 200.640(a) and 200.610(a).

³ The Company cannot be heard to object to administrative notice being taken of Opinion No. 531 as it is the Company that introduced the opinion in the first place.

⁴ Short-term growth rate is security analysts' five-year forecasts for each company in the proxy group, as published by the Institutional Brokers Estimate System (IBES). Long-term growth is based on forecasts of long-term growth of the economy as a whole, as reflected in GDP. Opinion No. 531 ¶ 17.

10.00 (Rev.), 24.) FERC noted that five-year growth projections, like the one utilized by IAWC, are “limited to too brief a time period to meet the requirements of the DCF model.” Opinion No. 531 at ¶ 19 (internal citations omitted).

Opinion No. 531 establishes the long-term growth rate as the forecasted GDP of the economy as whole, which Staff testified is 4.2%. (Staff Ex. 5.0, 11.) In direct contrast to the FERC order, the Company testified that it disagrees with the use of the forecasted GDP of the economy as a whole as an appropriate indicator of long-term growth, saying “[e]ven if GDP growth represented the maximum theoretical limit for long-term growth rate for some companies, Staff’s calculation of long-term GDP growth is understated and not needed in the public utility context.” (IAWC, 10.00R, 10.) The Company suggests that the future growth rate is projected at 6%⁵ (IAWC IB, 16) but estimates long-term GDP growth to be 4.5%. (IAWC 10.00R, 10.)

Further, the FERC order establishes that, once a range of reasonable ROEs is established for companies in the proxy group, the ROE for the subject company must fall within that range. Opinion No. 531 ¶ 151. Mr. Moul did not even present ROEs for the individual companies in his proxy group, which is required by the FERC methodology. Additionally, Opinion No. 531 also states that additional methodologies such as CAPM or a risk premium analysis are useful for determining where in the DCF range the final ROE should fall but that the ROE must still be within the DCF range. Opinion No. 531 ¶ 146. This is contrary to Mr. Moul’s approach of determining an ROE using an average of DCF and CAPM analyses and then tacking on adjustments which he justifies through additional

⁵ As noted in Staff’s IB, the Company’s growth rate increased without explanation to 6.25% in its rebuttal testimony. (Staff IB, 11.)

methodologies. In other words, the Company's evidence does not support – indeed it is directly contrary to – the use of the FERC analysis.

Clearly, to suggest that an analysis using FERC methodology supports Mr. Moul's ROE recommendation ignores the fact that Mr. Moul's DCF analysis would need to be significantly overhauled in order to be consistent with FERC methodology. Significantly, Mr. Moul's growth rate would go down when the long-term GDP is properly considered, resulting in a lower ROE recommendation.

WHEREFORE, for all the reasons set forth above and in Staff's Motion, the Staff of the Illinois Commerce Commission respectfully requests the Administrative Law Judges grant its Motion to Strike. In the alternative, Staff requests that the ALJs take administrative notice of FERC Opinion No. 531 so that Staff and all parties can cite to it as liberally as the Company does.

Respectfully submitted,

/s/

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